STATE OF MICHIGAN

IN THE SUPREME COURT

INNOVATION VENTURES, LLC,

Plaintiff/Appellant,

v.

LIQUID MANUFACTURING, LLC, K&L DEVELOPMENT OF MICHIGAN, LLC, LXR BIOTECH, LLC, ETERNAL ENERGY, LLC, ANDREW KRAUSE, and PETER PAISLEY,

Defendants/Appellees.

Supreme Court No. 150591

Court of Appeals No. 315519

Lower Ct. No. 12-124554-CZ

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BRIEF ON APPEAL OF APPELLEES LIQUID MANUFACTURING, LLC, K&L DEVELOPMENT OF MICHIGAN LLC, ETERNAL ENERGY, LLC, LXR BIOTECH, LLC, AND ANDREW KRAUSE

*****ORAL ARGUMENT REQUESTED*****

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STATEMENT OF JURISDICTION

Appellees concur with Appellant's statement of jurisdication.

COUNTER-STATEMENT OF QUESTIONS INVOLVED

Eternal Energy is an "energy shot" that competes in an industry dominated by appellant's 5-Hour Energy product. Appellant acknowledges that the only way to bottle competing products like Eternal Energy is to use Liquid Manufacturing, Inc., as its bottler. No other comparable bottling operation exists.

Appellant, through a series of anti-competition agreements, seeks to protect its 91% market share and healthy margins by picking and choosing which products it will allow Liquid to bottle. Niche products with limited distribution are approved. Products distributed more broadly are rejected.

Appellant sued attempting to enforce the anti-competition agreements, and also asserted various tort claims. The trial court and Court of Appeals agreed that appellees were entitled to summary disposition of all claims against them. The courts decided that the anti-competition agreements that purported to restrain trade were invalid, that appellant's alleged trade secrets were not infringed, that appellees agreements with K&L Development and Krause were unenforceable on consideration grounds, and that all claims should be dismissed.

I. Should this Court affirm the courts below and hold that the non-compete portions of the K&L Anti-Competition Agreement and Liquid Termination Agreement are unenforceable unreasonable restraints of trade:

A. Where the purpose of a non-competition clause must be greater than merely preventing competition and the appellant has the burden to show that the provisions protect legitimate business purposes, and where appellant admitted that the purpose of the Liquid Termination Agreement was to allow it to pick and choose which competitors would be allowed to use Liquid's bottling equipment, and to preclude Liquid from bottling for competitors with potentially broad distribution and production;

B. Where, to be valid, the restraint contracted for must appear to have been for a just and honest purpose, for the protection of the legitimate interest of the party in whose favor it is imposed, and appellant presented the K&L Anti-Competition Agreement to K&L in bad faith, after K&L has worked under an oral agreement for several years, with promises that K&L would be retained for additional work, and then dismissed K&L 13 days after the agreement was signed, without ever providing K&L with the promised work?

The Trial Court answered, "Yes."

The Court of Appeals answered "Yes," as to the Liquid Termination Agreement. The Court of Appeals did not expressly address the unreasonableness of the K&L Anti-Competition Agreement.

The appellant answers, "No."

The appellees answer, "Yes."

II. Should this Court affirm the Court of Appeals and hold that the appellant's agreements with K&L are void for failure of consideration, which occurs when there is a failure to perform a substantial part of the contract or failure of one of its essential terms, or when the contract would not have been made if default in that particular had not been expected or contemplated, and where appellant presented the K&L Anti-Competition agreement to K&L in bad faith, after K&L has worked under an oral agreement for several years, with the promise that K&L would be retained for additional work, and then dismissed K&L 13 days after the agreement was signed, without ever providing K&L with the promised work? Alternatively, should the Court hold that Andrew Krause, individually, is not bound by the K&L Anti-Competition Agreement, because he is not a party to the agreement and did not execute it in his personal capacity?

The Trial Court and Court of Appeals answered "Yes." The Court of Appeals did not address the alternative ground.

The appellant answers, "No."

The appellees answer, "Yes."

III. The trial court granted summary disposition of appellant's trade secret claim before discovery had concluded. Should leave be denied, where appellant had an adequate time for discovery, where further discovery did not stand a fair chance of uncovering information likely to create an issue of fact precluding summary disposition, and where appellant could never show the nature of the trade secret allegedly misappropriated?

The Trial Court and Court of Appeals found that no further discovery was warranted.

The Appellant answers, "No."

The Defendants answer, "Yes."

IV. Should the dismissal of all other claims be affirmed, where appellant has not sought reversal of the remaining holdings of the Court of Appeals and Trial Court in this Court?

Appellees answer: "Yes."

INTRODUCTION

Appellant, the manufacturer of the 5-Hour Energy Shot, controls 91% of the energy shot market. As appellant admits, there are no "turnkey" bottling operations for energy shots, other than appellants', and that of appellants' former bottler, Liquid Manufacturing LLC. Appellant further admits that, through a "Termination Agreement" with Liquid, appellant can control which competitors have access to Liquid, and which do not. Appellant admitted that the rationale for its agreement with Liquid gave it "the right to evaluate, **on a case-by-case basis, each brand of energy drink that Liquid Manufacturing proposed to bottle.**" It admitted that it only allowed Liquid to bottle products that "were **limited in distribution and production.**" (Appx. 152b, Interrogatory Responses at p. 31) (emphasis added).

Appellees Eternal Energy LLC and LXR Biotech LLC manufacture the competing Eternal Energy energy shot. They sought to have the shot bottled by appellee Liquid. Appellant initially approved allowing Liquid to bottle Eternal Energy. At the time, Eternal Energy was not yet on the market, and its distribution strategy included marketing through tattoo parlors.

However, after a Wal-Mart representative sampled Eternal Energy at a tattoo convention and liked the product, a relationship developed that ultimately resulted in Eternal Energy obtaining a $40 million Wal-Mart contract, putting Eternal Energy in direct competition with 5-Hour Energy in a major retailer.

Facing competition from a low-priced competitor at one of its biggest customers, appellant purported to terminate Liquid's ability to bottle products, and filed potentially ruinous litigation against appellees. Appellee freely admits that its change in position was "**because [Eternal Energy] was ultimately distributed to a significantly broader area** than originally proposed." *Id.*

Appellant's attempts to use anti-competition agreements to control the distribution of competing products are an inherently unreasonable restraint of trade. Preventing competition is an impermissible purpose for a non-compete agreement. *St. Clair Med. PC v Borgiel*, 270 Mich App 260, 266, 268 (2006). Furthermore, while a manufacturer "generally has a right to deal or refuse to deal, with whomever it likes," it must do so "independently." *Montsanto Co. v. Spray-Rite Serv. Corp.*, 465 U.S. 752, 761 (1984). When evaluating a restraint of trade, "the critical question is whether the challenged anticompetitive conduct 'stem[s] from [an] independent decision or from an agreement, tacit or express.'" *Bell Atlantic Corp. v. Twombly,* 550 U.S. 544, 553 (2007), *quoting Theatre Enters., Inc. v. Paramount Film Distrib. Corp.,* 346 U.S. 537, 540 (1954).

Here, appellant engaged in a series of anti-competitive acts designed to control the distribution of competing products. In bad-faith, it obtained written anti-competition agreements from appellees K&L Development of Michigan and Andrew Krause, contractors who had worked for years under oral agreements, by promising them orders of new machinery, then dismissed them 13-days later without providing the agreed upon consideration. Appellants further entered into agreements with appellee Liquid Manufacturing LLC that appellant claims prohibit Liquid from using Liquid's own equipment to bottle competing products, unless approved by appellant.

The trial court and court of appeals correctly held that the anti-competition agreements between appellant, K&L, and Krause, and between appellant and Liquid, were unenforceable, and that the K&L agreements were void for failure of consideration. This Court should affirm.

COUNTER-STATEMENT OF FACTS

A. Parties.

Innovation Ventures LLC ("Appellant") manufactures and distributes the 5-Hour Energy Shot. (Appx. 318a, Trial Court Op.). 5-Hour Energy has sold more than 700 million units since 2004 and is found in more than 100,000 retail outlets in the U.S. and Canada. *Id.* Appellant stipulated that it holds a 91% market share for energy shots in the U.S. *Id.*

Appellee Liquid Manufacturing LLC ("Liquid") formerly bottled 5-Hour Energy under an Amended Manufacturing Agreement ("Liquid Manufacturing Agreement") (Appx. 63a). **Appellee Peter Paisley ("Paisley")** is the President and CEO of Liquid. (Appx. 318, Trial Court Op.).

Appellant retained a**ppellee K&L Development of Michigan LLC ("K&L)** in October, 2007 to improve the quality of its manufacturing and packaging processes. (Appx. 225a, Henderson affidavit). K&L designed, manufactured and installed production and packaging equipment used by Liquid to bottle 5-Hour Energy under an oral agreement. *Id.* **Appellee Andrew Krause ("Krause")** was the managing member of K&L. (Appx. 86a).

Krause's work was limited to "equipment design utilized in packaging a two pack for the 5 Hour Energy product, and improving the efficiencies of the production line." (Appx. 188b, 1/14/13 Krause Affidavit, ¶3). He had "no responsibility for business development, customer relationships, sales or personnel employed by Five Hour." *Id.* Krause "had no access to and was never given any Confidential Information regarding the 5 Hour Energy drink." (Appx. 8a, 2/9/12 Krause Affidavit, ¶4).

Appellees Eternal Energy, LLC ("Eternal Energy") and LXR Biotech, LLC ("LXR") were formed in September, 2010 and May of 2011, respectively, well after K&L and Krause's contracts with appellant were terminated. (Appx. 29a-30a, Second Amended

Complaint at ¶¶ 57-65). Krause was a member and minority owner of these LLCs. (Appx. 319a, Trial Court Op.). Eternal Energy and LXR developed an energy shot called "Eternal Energy." *Id.* Eternal Energy is a lower cost competitor to 5-Hour, with a different formula. *Id.*

B. The Parties' agreements.[1]

1. Contracts among appellant, K&L, and Krause.

K&L and Krause built and installed bottling and packaging equipment for appellant beginning in October, 2007. (Appx. 16a, Second Amended Complaint at ¶ 4). They operated under an oral agreement for one and one-half years. (Appx. 225a, Henderson affidavit).

Appellant admits that, when companies "have access to [its] Confidential Information," it requires confidentiality, non-disclosure and non-competition agreements." (Appx. 20a, Second Amended Complaint at ¶ 23). It also "strictly limit[s] the Confidential Information" to employees and suppliers who need it. *Id.* Noting in the record suggests that either K&L or Krause were asked to sign a non-compete or confidentiality agreement when they were hired, or for that matter at any time until just before they were terminated. There are no allegations in the complaint that Appellant provided K&L or Krause with any training, education or expertise. (Appx. 319a, Trial Ct. Op.).

After operating under an oral arrangement since October, 2007, in late April, 2009, for the first time, appellant presented K&L with two written agreements.

The K&L Manufacturing Agreement. Effective April 27, 2009, appellant, Krause, and K&L entered into a written K&L Manufacturing Agreement, which purported to confirm their

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1 There are no contracts between appellant, Eternal Energy, and/or LXR. Eternal Energy and LXR have no contractual bar from competing with appellant. Appellant brought trade secret and non-contractual tort claims against Eternal Energy and LXR. All such claims were dismissed by the trial court, and affirmed by the court of appeals. The only claim on appeal to this Court that relates to Eternal Energy and LXR is appellant's trade secrets claim.

earlier oral agreement. (Appx. 76a). The K&L Manufacturing Agreement contains an "Exclusivity" provision, under which K&L and Krause are allegedly precluded from designing or manufacturing bottling equipment within North America for a period of five-years. (Appx. 83a, K&L Mfg. Ag. § 10). The K&L Manufacturing Agreement states that it is the entire agreement of the parties, and that it supersedes all other agreements, oral and otherwise, regarding the subject matter of the agreement. (Appx. 85a, § 20).

The manufacture and design of bottling equipment is not at issue in this case, and though cited in appellant's brief, the anti-competition provisions of the K&L Manufacturing Agreement are irrelevant to this appeal.[2] Appellant does not dispute that Krause has "not designed or constructed similar equipment for any other company." (Appx. 189b, 1/4/13 Krause Affidavit,¶5).

The K&L Anti-Competition Agreement. Also effective April 27, 2009, Appellant and K&L (but, importantly, not Krause) entered into a new agreement, titled Nondisclosure and Confidentiality Agreement ("K&L Anti-Competition Agreement") (Appx. 94a).

Unlike the K&L Manufacturing Agreement, the K&L Anti-Competition Agreement does not indicate that its purpose is to confirm prior oral agreements. Indeed, it is inconsistent with the K&L Manufacturing Agreement in many ways, and provides a number of new, broader, and more cumbersome provisions.

The K&L Anti-Competition Agreement purports to bar K&L from:

(A) Having an interest in, aiding, or assisting someone with an interest in, a business or enterprise in North America that competes with appellant in any way, including the formulation, manufacture, production, or distribution of liquid energy supplements sold in 1-4 ounce bottles;

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2 The K&L Manufacturing Agreement also contains a confidentiality provision that was relevant in the Court of Appeals, but the Court of Appeals finding that the agreement's confidentiality provisions were not breached has not been appealed to this Court.

(B) Soliciting, diverting, interfering with, or accepting any business from appellant's customers or prospective customers;

(C) Employing or attempting to employ Appellant's employees. (Appx. 97a, §6).

The K&L Anti-Competition Agreement also purports to be the parties "whole agreement" relating to its subject matter, that "merges and extinguishes" prior drafts and agreements. (Appx. 98a, §18).

Appellant terminates K&L and Krause thirteen days later. The agreements among the parties contemplated that appellant would continue to utilize K&L's services. (Appx. 76a, 94a). K&L and Krause understood that appellant would order "between four and six" new machines. (Appx. 14b, Joint Motion to dissolve TRO at 8, verified by Appx. 13a, 2/9/12 Krause Affidavit, ¶ 19).

But the day after appellant had K&L and Krause sign the K&L Manufacturing Agreement, and had K&L sign the K&L Anti-Competition Agreement, K&L and Krause had "a new boss" who was asking "technical questions" about the bottling line. (Appx. 315a). Then, just thirteen days after the agreements were executed, on May 10, 2009, K&L and Krause were terminated. (Appx. 14b, Summary Disposition Motion at 2, verified by Appx. 188b, 1/4/13 Krause affidavit, ¶2). According to Krause, "I did not know and had no idea that Five Hour was going to terminate its relationship with K&L or with me." (Appx. 188b, 1/14/13 Krause Affidavit, ¶ 4). Appellant did not order the equipment contemplated by the agreements. (Appx. 14b, Joint Motion to dissolve TRO at 8, verified by Appx. 13a, 2/9/12 Krause Affidavit at ¶ 19).

2. <u>Contracts among appellant, Liquid, and Paisley.</u>

The Liquid Amended Manufacturing Agreement. In March of 2007, appellant and Liquid entered into an Amended Manufacturing Agreement ("Liquid Manufacturing Agreement") under which Liquid agreed to bottle and package 5-Hour Energy. (Appx. 63a). At that time, some of the equipment ("Buyer Equipment") used to bottle the product was owned by Appellant, and some of the equipment ("Manufacturer Equipment") was owned by Liquid. (Appx. 63-64a). Liquid had the right under the agreement to use its equipment to produce other products in the event that there were no unfilled orders from Appellant, except that the contract purported to forbid Liquid from producing or formulating other "Energy Drinks" in packaging of 4 ounces or less, or from packaging Energy Drinks containing certain ingredients. (Appx. 66-67a, 70a).

The Liquid Termination Agreement. In 2010, appellant decided to take its bottling operation in-house, and discontinued its relationship with Liquid. On April 22, 2010, Appellant and Liquid entered into an "Agreement To Terminate the Manufacturing Agreement" (the "Liquid Termination Agreement") (Appx. 101a).[3]

In the Liquid Termination Agreement, the parties confirmed that appellant had terminated the Liquid Manufacturing Agreement for convenience, appellant exercised its $1.00 option to purchase the Manufacturer's Equipment, and appellant purported to impose a new anti-competition provision. (Appx. 101a, Recital C; Appx. 104a, ¶ 6; Appx. 101a, ¶ 1(a)).

In exercising the option to purchase, the parties agreed that the equipment would remain at Liquid's facility for one year, and that Liquid could use the equipment, but that Liquid would insure the equipment, keep it in good working order, and fill appellant's orders (up to 11,000,000 units) on a priority basis and on demand, using Liquid's personnel. (Appx. 104-105a, ¶6). Thus, though appellant had decided to take its bottling operation in-house, the Termination Agreement allowed it a location to house surplus equipment, and keep it on ready status, with Liquid paying

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[3] The Court of Appeals held that Paisley signed the Termination Agreement only in his capacity as corporate officer, and could not be personally bound by its terms. (Appx. 359a, COA Op., at 6). That decision has not been appealed.

for insurance and maintenance, all with priority access at a low price in case appellant needed additional bottling capacity.[4]

Under the new anti-competition clause, appellant and Liquid agreed to limit competitors' access to the bottling equipment to those selected by appellant. Section 1(a) of the Termination Agreement provides: "LE hereby grants Liquid permission to manufacture the Permitted Products (as defined in Section 24 below) subject to each of the conditions of this Agreement. *Id.* Section 1(b) of the Termination Agreement precluded Liquid from bottling other energy drinks:

> (b) Other than the Permitted Products, for a period of 3 years from the Effective Date, Liquid shall not produce or formulate other than for LE (i) any Energy Drink (as defined in Section 24 below), in packaging of 4 fluid ounces or less, or (ii) any other Energy Drink containing glucuronolactone or tyrosine (in all its forms) regardless of package size (Appx.102a, § 1(b)).

The Termination Agreement thus authorized Liquid to bottle on behalf of some "permitted" enterprises, but then purported to grant appellant the absolute right to prevent Liquid from manufacturing for all other competitors without appellant's consent. *Id.* The Termination Agreement offered no rationale for why it was permissible for appellant to select the enterprises for which Liquid could bottle.

Section 24(i) of the Liquid Termination Agreement allowed Liquid to manufacture those "Permitted Products" identified on a schedule, exhibit C, to the Termination Agreement. (Appx 110-111a). Exhibit C to the Termination Agreement originally listed 36 different competing Permitted Products that appellant expressly authorized Liquid to bottle. (Appx. 114a).

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4 In its brief, appellant ascribes only altruistic motives for allowing Liquid to bottle other products. However, there were considerable economic benefits to appellant from the Termination Agreement.

Appellant also required that Liquid's "Permitted Products" customers to sign a Confidentiality Agreement. But the confidentiality agreement obliged those competitors to keep confidential only one single fact -- that their product was being bottled at a plant that previously bottled for appellant. (Appx. 103a, ¶4; Appx. 115a, Exhibit D). This was the sole matter that appellant required Liquid's customers to keep secret. *Id.* Appellant did not require that Liquid enter into a confidentiality agreement with its customers to protect other purported confidential information, even though appellant now contends that by the mere act of bottling energy drinks Liquid uses and discloses its confidential information and trade secrets.

Further, the Liquid Termination Agreement did not require that Liquid's customers agree to keep confidential, or not use, any of the information that Liquid previously obtained from appellant. *Id.* Appellant even expressly authorized Liquid to disclose to its customers that Liquid "previously bottled 5 Hour Energy," and it agreed that appellant's "president will confirm to prospective customers of Liquid orally that [appellant] did not terminate its Manufacturing Agreement with Liquid for reasons related to Liquid's performance." *Id.*

The Termination Agreement contains a provision allowing appellant to revoke its authorization for Liquid to bottle Permitted Products "for Liquid's violation of this Agreement." (Appx. 101a, § 1(a)). However, the agreement also provided that Liquid had a 30-day cure period. *Id.*

The Liquid Equipment Purchase Agreement. Less than a year later, on March 8, 2011, appellant agreed to sell the equipment back to Liquid for $275,000. (Appx. 122a).

3. Contract Summary.

For ease of reference, this chart summarizes the key provisions of the contracts among the parties:

	K&L Mfg	K&L Anti-Competition	Liquid Amended Manufacturing	Liquid Termination	Liquid Equipment Purchase
Contract Date	4/27/09	4/27/09	5/18/07	4/22/10	3/8/11
Parties	Appellant, K&L, Krause	Appellant, K&L	Appellant, Liquid	Appellant, Liquid	Appellant, Liquid
Anti-Compete Clause	Cannot design or produce bottling equipment for 5 years.	Cannot compete, in any way, in North America for 3 years.	Can bottle non-competing products if excess capacity exists.	Cannot bottle competing products, except Permitted Products, for 3 years.	None.
Other key terms	States that it memorializes prior oral agreement; Purports to be only agreement of the parties, supersedes all other agreements.	New agreement; also purports to be "whole" agreement of the parties, superseding other agreements.	Appellant and Liquid each own a portion of the equipment used in the bottling process.	Appellant exercises option to purchase Liquid equipment, but keeps equipment at Liquid as a source of excess capacity for appellant.	

C. Krause forms a start-up competitor.

After appellant terminated their business relationship on May 10, 2009, Krause attempted to find other work. (Appx. 169b, Motion for summary disposition at 3, verified by Appx. 188b, 1/7/13 Krause Affidavit, ¶19). But Krause, a cancer survivor, has physical limitations, including the removal of his shoulder, and particularly during the difficult economic times of 2009, he found that there was little call for a "self-taught, one-armed production expert." *Id.* While he was able to obtain some new business for K&L for a project to build a production line for tattoo ink for a company called Eternal Ink, K&L soon ran out of opportunities, and went out of business in 2010. *Id.*

In the summer and fall of 2010, Krause decided to attempt to produce an energy drink. (Appx. 9a, 2/9/12 Krause Affidavit, ¶6). He researched the subject and partnered with Terry Welker, who owned the company that manufactured tattoo inks. *Id.* Krause found that there are more than a dozen companies that supply formulae and products for energy drinks.[5] (Appx. 9a, ¶8). In September, 2010, Krause contacted Glanbia PLC, an international nutritional laboratory, and Glanbia provided Krause with multiple formulations for various energy drinks. (*Id.,* ¶¶7-8; Appx. 27-42b, Exhibit 1 to affidavit). More particularly, Glanbia provided Krause with a public document from Seltzer Nutritional Technologies containing a complete analysis of ingredients for several energy drinks already on the market, along with a suggestion for the formulation for an energy drink for use by Krause. *Id.,* ¶ *9.* Krause and Welker obtained samples from Glanbia and selected the formula. *Id.,* ¶ *10.* They then worked with another company, Allen Flavors, to make flavor adjustments. *Id.* They called the new product Eternal Energy and initially used tattoo designs from artists on the product labels. *Id.*

Eternal Energy still needed a bottler. There were no "turnkey energy shot manufacturing lines," except for those developed by appellant and appellees. (Appx. 228a, Henderson Affidavit, ¶15). So Krause approached Liquid. (Appx. 10a, Krause Affidavit, ¶11).

[5] While Krause did not use the 5-Hour Energy formula, 5-Hour's formula was and is in the public domain. 5-Hour submitted a patent application that disclosed its formulation. Appx. 43b. Obviously, under such circumstances, 5-Hour's formula cannot be considered confidential or a trade secret.

D. Eternal Energy Becomes a "Permitted Product."

As noted above, the Termination Agreement provided that Liquid could bottle additional Permitted Products only if appellant agreed. (Appx 110a, ¶24(i)). On September 20, 2010, Liquid asked appellant to amend the Permitted Products list and add the Eternal Energy shot. (Appx. 147a). Noting that the product was "not yet on the market," Liquid provided appellant with provisional label artwork (which, as noted above, was based on tattoo artists' renderings), formula and website address. *Id.* Liquid expressly disclosed that Eternal Energy's formula included both glucuronolactone and tyrosine. *Id.* Appellant agreed, in writing, to approve the Eternal Energy shot as a Permitted Product. *Id.*

E. A "life altering" event.

In April, 2011 (by which time appellant had re-sold the bottling equipment to Liquid), Eternal Energy was on display at a tattoo convention in Detroit. (Appx. 11a, 2/9/12 Krause Affidavit, ¶13). A Wal-Mart representative attended the convention, sampled and liked the product. *Id.* He followed up with Krause and solicited the possibility of sales through Wal-Mart. *Id.* Ultimately, an agreement was reached.

As Krause said, the Wal-Mart relationship was "a life altering event for Eternal Energy and myself." (Appx. 11a, 2/9/12 Krause Affidavit, ¶13). Krause and eternal energy spent months working on supplying the product to Wal-Mart, investing hundreds of thousands of dollars to do so. *Id., ¶ 15;* Appx. 15b, Motion to Dissolve TRO at 9, verified by Appx. 13a, 2/9/12 Krause Affidavit, ¶19).

F. Appellant attempts to revoke the Liquid Termination Agreement and files suit.

With Eternal Energy establishing a foothold at Wal-Mart, appellant decided it needed to crush its new rival. By letter dated January 27, 2012, the same day the instant lawsuit was filed, appellant claimed that Liquid had breached the Termination Agreement and purported to revoke Liquid's authorization to produce Permitted Products. (Appx. 51a, *Second Amended Complaint* at ¶ 157). The attempted revocation was inconsistent with the provisions of the Termination Agreement, which required notice of and a 30-day opportunity to cure any breach and avoid revocation. (Appx. 101a, § 1(a)). It is undisputed that appellant did not provide Liquid with notice or an opportunity to cure before its January 9, 2012 termination letter.

G. <u>Trial Court Claims and Proceedings.</u>

Though appellant now complains that summary disposition was premature, the record reveals a case that was actively litigated for a year, with numerous hearings and conferences conducted by the trial court. Through the motions for a temporary restraining order, preliminary injunction, summary disposition, protective orders, and on procedural issues, the trial court became acutely aware of the facts, circumstances, and legal issues involved in the case, and had the benefit of extensive briefing when it issued its well-reasoned 37-page opinion dismissing appellants' claims. (Appx. 317a)

1. <u>Appellant sues and obtains an ex parte temporary restraining order, which is later dissolved by the trial court.</u>

Appellant brought suit on January 27, 2012, and immediately obtained an *ex parte* temporary restraining order that essentially stopped Liquid's production and the production of Eternal Energy. (Appx. 2a). Defendants filed a motion to dissolve the TRO. (Appx. 7b). They argued that the TRO would put LXR and Eternal Energy out of business, because it did not allow them to ship product to its customers, including Wal-Mart. (Appx.72b, Transcript of February 10, 2012 Hearing, at 15). They pointed out that public policy did not favor allowing competitors to use lawsuits to stifle competition, noting that appellant had an admitted history of using litigation as a means of crushing competitors, and citing an interview in *Forbes* magazine with appellant's founder, Manoj Bhargava:

> In one corner of Manoj Bhargava's office is a cemetery of sorts.... His company, Living Essentials, is the biggest player by far in the energy-shot market, and not because 5-Hour is so delicious.... The reason Bhargava has won is that he plays tough. Sitting in that cemetery are a dozen or so neon copycats with names like 6-Hour Power and 8-Hour Energy. Each has been sued, bullied or kicked off the market by Living Essentials' lawyers. In front of each are little placards with a skull and crossbones drawn in felt-tip pen. Bhargava points to the gravestone of one of his late competitors and says with a chuckle, 'rest in peace.' (Appx. 2b, *Forbes Magazine, The Mystery Monk Making Billions with 5-Hour Energy,* 2/27/12).

Defendants also argued that appellant could not demonstrate irreparable harm, particularly given appellant's 91% market share. (Appx. 77b, Transcript of 2/10/12 Hearing at 20).

In ruling that the TRO should be lifted, the trial court made plain that it had serious questions about whether Appellant's lawsuit had merit, and whether its true purpose was to stifle competition in violation of Michigan's public policy:

> THE COURT: ... I quite frankly think that you have a -- an action for money damages, if you have that, and I'm not seeing the irreparable harm that would come to your client, I'm not seeing the likelihood of prevailing on the merits, and in terms of public policy, to allow your client to -- to -- you know, to crush competitors is certainly something that's not supported by public policy. (Appx. 116b at 59).

The trial court maintained a TRO that precluded the dissemination of certain information, but dissolved the portion that prevented Liquid, Eternal Energy, and LXR Biotech from conducting business. *Id.* at pp. 58-59.

2. Appellant files a Second Amended Complaint.

Appellant ultimately filed a second amended complaint, setting out claims against Liquid and Paisley alleging violation of the noncompetition provisions of the Termination Agreement or the alleged improper use of confidential information or trade secrets. (Appx. 15a, Second Amended Complaint).

Appellant's claims against K&L and Krause were based on the non-competition and confidentiality provisions of the K&L Manufacturing Agreement and K&L Anti-Competition Agreement.

Appellant's claims against Eternal Energy and LXR Biotech were various tort claims associated with the breaches of contract asserted by appellant against K&L, Krause, Liquid, and Paisley.

3. Defendants file initial summary disposition motions.

On June 15, 2012, before discovery began, defendants moved for summary disposition on all claims. The motions were fully briefed, and the trial court entered an Opinion and Order initially denying summary disposition motions filed by the defendants. (*See, e.g.,* Appx. 317a).

4. The parties conduct discovery, and appellant admits that it intended to limit competition.

After the trial court denied the initial motions for summary disposition, the parties agreed to bifurcate the proceedings and conduct discovery on liability. The Court entered a scheduling order that provided that discovery would end on October 31, 2012, just four months later. During discovery, appellant made a key admission. Answering an interrogatory requesting appellant to detail how its legitimate business interests were harmed by Liquid bottling non-Permitted Products, appellant answered:

> Under the Agreement to Terminate, Plaintiff had the right to evaluate, **on a case-by-case basis, each brand of energy drink that Liquid Manufacturing proposed to bottle**. Products that were approved by Plaintiff were **limited in distribution and production**, such that Plaintiff believed that the bottling of the product would not infringe on Plaintiff's legitimate business interests.... Plaintiff's legitimate business interest in protecting its goodwill and confidential information was harmed. For example, Plaintiff's legitimate business interests in protecting its goodwill and confidential information are harmed by Liquid

> Manufacturing's bottling of Eternal Energy **because it was ultimately distributed to a significantly broader area** than originally proposed and provisionally approved. (Appx. 152b, Interrogatory Responses at p. 31 (emphasis added)).

5. <u>The trial court dismisses appellant's claims.</u>

Both sides filed motions for summary disposition. The trial court granted appellees' motions in a well-reasoned, 37-page opinion. (Appx. 317a). The opinion fully analyzed each of the relevant agreements and each of appellant's claims. The trial court agreed with authorities holding that a "business interest justifying a restrictive covenant must be greater than merely preventing competition." (Appx. 337a). "[M]erely preventing competition is not justification for an noncompetition agreement." (Appx. 338a). Reviewing appellant's answers to interrogatories, the trial court found that appellant "does not cite any *unfair advantage* the agreement sought to prohibit." (Appx. 339a) (emphasis in original). "The only concrete example given by Appellant is the intent to prohibit competition of those products with a potential for broad distribution. If the only intend of the agreement was to prevent competition, then the agreement, on its fact, is invalid." *Id.*

The trial court also rejected the notion that having Liquid bottle Eternal Energy could give LXR or Eternal Energy confidential information that would provide an unfair advantage. "Once plaintiff allowed Liquid to use the equipment to bottle 37 different products, all of the information that could be obtained from the use of that equipment, and any resultant business advantage, because public knowledge and could not form the basis for a claim of *unfair* advantage." (Appx. 339a) (emphasis in original).

Another factor informing the trail court's decision was the sale of the bottling equipment to Liquid. "Liquid paid $275,000 for the purchase of the equipment.... Having benefited from the sale of the equipment … it is inherently unreasonable … to prohibit the use of that equipment after consummating the sale." (Appx. 340a).

The trial court also found that the K&L Anti-Competition Agreement failed for lack of consideration. (Appx. 341a). The trial court noted that "K&L was not given any additional work under the contract," which was terminated "[w]ithin a matter of days" after the agreement was executed. The trial court further found the agreement to be unreasonable. "If such a promise had been extracted from K&L at the beginning of the relationship … it might have been unreasonable, however the agreement was entered into at a time when K&L would derive no further benefit." However, "[c]oming as it did, when Plaintiff knew that it would be terminating its relationship with K&L, the covenant not to compete is inherently unreasonable." (Appx. 343a). "The facts surrounding the signing of the [agreement] do not support a determination that it was done for a just and honest purpose, nor that it was for the protection of a legitimate interest of the Plaintiff." (Appx. at 344a).

The trial court also rejected appellant's trade secret claims. "[A] simple reading of MUTSA reveals no trade secrets have been misappropriated, because the information in question does not meet the statutory definition of a trade secret." (Appx. 345a). Citing cases holding that parties must particularize and identify the purported misappropriated trade secrets with specificity, and that trade secrets must, of necessity, "be a secret," the trial court held that "Plaintiff has not kept [knowledge of the bottling process] secret and has permitted its disclosure." (Appx. 345a). "[T]he information is generally known, because it is used with the approval by 37 different manufacturers of energy drink products." *Id.*, 345-346a.

The court also dismissed appellant's tort claims, which are not a subject of this appeal. (Appx. 346-352a).

6. **Proceedings on Appeal.**

Appellant appealed as of right. The Court of Appeals affirmed the trial court in an unpublished, *per curium* opinion. (Appx. 354a). The Court of Appeals agreed with the trial court that "noncompetition agreements are disfavored as restraints on commerce and are only enforceable to the extent they are reasonable." (Appx. 359a). The Court of Appeals further agreed that "the non-compete provision contained in the [Liquid] Termination Agreement was unreasonable and unenforceable." (Appx. 360a). Noting appellant's burden to justify the legitimate purpose of the anti-competition agreement, the Court of Appeals pointed to appellant's interrogatory answers. It found that "[b]y plaintiff's own admission, plaintiff used the non-compete provisions to approve the bottling of those products that were 'limited in distribution and production' thereby allowing plaintiff to handpick the competing products that defendant Liquid Manufacturing could bottle." *Id.*

"While preventing unfair competition is a legitimate business purpose … the prevention of fair competition is not." (Appx. 360-61a). "Where … Liquid only bottled products … such a broad restraint … was unreasonable…. [T]his is particularly so where plaintiff subsequently sold the bottling equipment to … Liquid, then sought to use the non-compete provisions to control what … Liquid could do with its own equipment." (Appx. 361a).

The Court of Appeals also found that the K&L agreements were unenforceable for a failure of consideration. (Appx. 363a). "[T]here was no genuine issue of material fact that the discontinuation of the business/employment relationship within two weeks of the signing of the agreements constituted a failure of consideration." *Id.* "Krause and K&L Development never received that which they were promised under the agreements." *Id.*, 364a. "[C]onsideration requires a bargained-for exchange…. Where plaintiff terminated the business relationship within two weeks after the agreements were signed, plaintiff's forbearance in terminating the relationship amounted to a nullity." *Id.*

The Court of Appeals also affirmed the dismissal of appellant's trade secret and tort claims. (Appx. 365-370a).

7. <u>This Court grants leave to appeal.</u>

This Court granted leave to appeal by order dated July 1, 2015. The Court directed the parties to include among the issues briefed (1) whether the K&L Equipment Manufacturing Agreement and K&L Anti-Competition Agreement are void due to failure of consideration, and (2) whether the non-compete provision in the K&L Anti-Competition Agreement and Liquid Termination Agreement are reasonable.

<u>ARGUMENTS</u>

I. STANDARD OF REVIEW.

This Court reviews summary disposition decisions *de novo.* *Maiden v. Rozwood,* 461 Mich 109, 118 (1999).

II. THE K&L AND LIQUID ANTI-COMPETITION AGREEMENTS ARE UNENFORCEABLE AS UNREASONABLE RESRAINTS OF TRADE.

The only relevant anti-competition provisions are found in the K&L Anti-Competition Agreement (to which Krause is not a party), and the Liquid Termination Agreement. The anti-compete clauses in both of those agreements are unenforceable.

A. <u>The K&L Anti-Competition Agreement</u>.

At common law, a person's right to use their own labor was protected by the courts for centuries. *See, e.g., The Dyer's Case, Y.B. 2 Hen. V Pl. 26* (1415) ("The obligation is void because the condition is against the common law, and by God, if the plaintiff were present he should rot in gaol till he paid a fine to the King."). A 1905 Michigan statute similarly barred non-compete agreements, declaring contracts "by which any person ... promises or agrees not to engage in any ... trade, profession or business" to be against public policy and void. 1905 PA 329 § 1, 1948 CL 445.761. The Michigan Antitrust Reform Act ("MARA") while barring a "contract, combination or conspiracy ... in restraint of ... trade," MCL 445.772, repealed the absolute statutory bar against non-competition agreements, and replaced that bar with a "rule of reason" analysis. *Bristol Window and Door, Inc., v. Hoogenstyn,* 250 Mich App 478, 492; 650 NW2d 670 (2002).

Nevertheless, "noncompetition agreements are disfavored as restraints on commerce and are only enforceable to the extent they are reasonable." *Coates v Bastian Brothers, Inc*, 276 Mich App 498, 507; 741 NW2d 539 (2007). Under this "rule of reason":

> [A] restrictive covenant must protect an employer's reasonable competitive business interests, but its protection in terms of duration, geographical scope, and the type of employment or line of business must be reasonable. *St. Clair Medical,* 270 Mich App at 266.
>
> [A] restrictive covenant must be reasonable as between the parties, and it must not be specially injurious to the public. Because the prohibition on all competition is in restraint of trade, an employer's business interest justifying a restrictive covenant must be greater than merely preventing competition. To be reasonable in relation to an employer's competitive business interest, a restrictive covenant must protect against the employee's gaining some unfair advantage in competition with the employer, but not prohibit the employee from using general knowledge or skill. *St. Clair Medical, supra* at 266 (citation omitted).[6]

The party seeking enforcement has the burden of demonstrating the validity of the covenant. *Id.* at 508. The reasonableness of a noncompetition provision is a question of law for the Court. *Id.* Non-competition agreements should be construed narrowly to avoid a threat to lawful competition. *United Rentals Inc. v. Keizer,* 355 F3d 399, 408 (CA 6 2004).

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6 Thus, a non-compete cannot bar competition -- it can only prohibit an "unfair advantage in competing." *See, generally,* Ryan Bewersdorf & Nicholas Ellis, *Protecting Competitive Business Interests Through Non-Compete Clauses: What Interests Can Legitimately Be Protected,* 30 Mich Bus L J (Issue 2) 40 (2010).

Noncompetition agreements are disfavored because the right to compete is a bedrock principle in our society. As this Court declared in *Meyers v. Roger J. Sullivan Co*, 166 Mich 193, 197; 131 NW 521 (1911), it would be a "monstrous doctrine" if a company could prevent competition with the stroke of a pen. Therefore, it is well-settled that preventing competition is an impermissible purpose for a non-compete. *St. Clair Med. PC v Borgiel*, 270 Mich App 260, 266, 268; 715 NW2d 914(2006).

Furthermore, as this Court explained in *Follmer, Rudzewicz v Kosco*, 420 Mich 394, 402, n 4; 362 NW2d 676 (1984), an employee's "know-how" belongs to the employee -- even if obtained from working for the employer:

> General knowledge, skill or facility acquired through training or experience while working for an employer appertain exclusively to the employee. The fact that they were acquired or developed during the employment does not, by itself, give the employer a sufficient interest to support a restraining covenant, even though the on-the-job training has been expensive and costly.

The K&L Anti-Competition Agreement purports to restrict K&L's ability to "engage in, have an interest in, or aid or assist any person or entity in conducting, engaging or having an interest in … any business or enterprise which is substantially the same as or is in competition with the business carried on by Living Essentials" anywhere in the United States, Canada, or Mexico for three years. *Ex. 5 at § 6.1.*

The K&L Anti-Competition Agreement serves no legitimate business purpose and is overbroad. K&L and Krause were retained as independent contractors to manufacture and maintain equipment used to bottle the 5-Hour Energy Shot. They worked without any written agreement for several years. Suddenly, on April 27, 2009, K&L and Krause were presented with an agreement that restrained them from competing with appellant in any way in all of North America for three years. A day later, Krause was introduced to his "new boss," Karl Smith, who asked Krause technical questions. (Appx. 315a). Less than two weeks later, K&L and Krause were terminated. As the trial court found, "the facts surrounding the signing of the [agreement] do not support a determination that it was done for a just and hones purpose, nor that it was for the protection of a legitimate interest of the Plaintiff." (Appx. 344a).

Further, K&L's and Krause's work "was limited to equipment design utilized in packaging a two pack for the 5 Hour Energy Product, and improving the efficiencies of the production line." (Appx. 21b, Krause Aff., ¶ 3). Krause was not in customer development, or sales. He wasn't involved in pricing, hiring or firing employees, or product development. His job was to design and maintain the machinery that bottled and packaged the product.

Under these circumstances, the non-competition agreement is unreasonably overbroad. An agreement that unduly limits a former employee's freedom to go into business for himself is unreasonable and unenforceable. *Follmer, Rudzewiz,* 420 Mich 394. 408 (1984). Unlike the K&L Manufacturing Agreement, the K&L Anti-Competition Agreement purports not to simply restrain K&L from designing, building and maintaining bottling equipment, but from *all* competition with appellant. It therefore is broader than needed to protect appellant's legitimate interests. See also, *Restatement (Contracts) 2d, Section 188(2)(b).*

The anti-competition provision of the K&L Anti-Competition Agreement does not seek prevent unfair competition. Rather, it purports to bar an equipment manufacturer, K&L, which had no involvement with appellant's customers, business development, pricing, or personnel, from being employed by a competitor in areas for which they had no prior responsibility or knowledge. Its breadth goes beyond the purpose of preventing K&L from unfairly competing. Indeed, the covenant's restrictions are completely detached from any experience, expertise or knowledge that may have been gained by K&L's association with appellant.

Given the over-breadth of the anti-competition clause, and the circumstances under which it was obtained, it is unreasonable and void as against public policy and cannot be enforced.

B. The Court of Appeals correctly affirmed the trial court's dismissal of the breach of anti-competition provisions in the Liquid Termination Agreement.

1. The standard set out in *Hubbard* does not differ from the standard set out in *St. Clair Med.*

Contrary appellant's statements in its briefs, all anti-competition agreements are inherently restraints of trade. The question is whether they are unreasonable restraints.

Courts apply the same standard when analyzing anti-competition provisions in vendor contracts and employment contracts. That standard is the rule of reason, and it is the standard applied by the Court of Appeals in this case. There are not two separate standards, as Appellant asserts.

Appellant argues that the rule of reason is derived from *Hubbard v. Miller,* 27 Mich 15, 19 (1873). *Hubbard* instructs that contracts in the restraint of trade are void in the abstract, but, can be valid "if, considered with reference to the situation, business objects of the parties, and in the light of all the surrounding circumstances … the restraint contracted for appears to have been for a just and honest purpose, for the protection of the legitimate interest of the party in whose favor it is imposed, reasonable as between them and not specifically injurious to the public." *Id.* Among the circumstances to be reviewed are whether the restraint is commensurate with the interests being protected and the territorial reach of the restriction. *Id.* at 19, 21-22.

MCL 445.774a states that, to be valid, a restrictive covenant must protect "reasonable competitive business interests," must be reasonable "in terms of duration, geographical scope, and the type of employment or line of business," and must be "reasonable as between the parties, and it must not be specially injurious to the public."

There is virtually no difference between the standard set out in *Hubbard,* which the Appellant says applies to commercial dealings among vendors, and that set out in MCL 445.774a, except that the statute is couched in terms of an employer-employee relationship. Both *Hubbard* and the statute instruct the courts to view the entirety of the circumstances, and determine if the restraints are reasonable between the parties and not injurious to the public. The Court of Appeals thus was correct in *St. Clair Medical PC v. Borgiel,* 270 Mich App 260, 265-66 (2006). when it viewed MCL 445.774a as codifying the common law rule.

Therefore, the entire thrust of Appellant's argument on its application fails. The Court of Appeals did not apply the wrong standard in this case. The standards set out in *Hubbard,* MCL 445.774a, and *St. Clair* are one in the same. There is no split or double standard in the Court of Appeals.

2. **<u>The Court of Appeals correctly applied the rule of reason</u>.**

The Court of Appeals applied the rule of reason in determining that the Liquid anti-competition provision was void. "[W]e agree that the non-compete provision contained in the Termination Agreement was unreasonable and unenforceable." (Appx. 360a, COA Op. at 7). Its holding was correct.

Much of the law concerning restraints of trade and the rule of reason is set out in section II.C., above and will not be repeated here. But the key to the lower court decisions is the rule that preventing competition is an impermissible purpose for a non-compete. *St. Clair Med.,* 270 Mich App at 266, 268. The alleged "sophistication" of the parties to the non-compete is not relevant. Even in cases where both parties are sophisticated, the party seeking the restrain still has "an obligation to demonstrate a legitimate business interest." *Guardian*

Fiberglass, Inc., v .Whit Davis Lumber Co., 509 F.3d 512, 526 (CA 8, 2007) (interpreting Michigan law).

Appellant set out two interests that it says justify the anti-competition provision of the Liquid Termination Agreement: confidentiality and goodwill. These alleged interests are pretextual. By their own admission, what Appellant sought was a means to control competition, control where competing products were sold, and maintain their 90% plus market share of the 1-4 oz. energy shot market. In particular, Appellant sought to maintain its stranglehold on distribution through Wal-Mart.

As Appellant admitted in answers to interrogatories, the "business purpose" it sought to advance was "the right to evaluate, on a case-by-case basis, each brand of energy drink that Liquid Manufacturing sought to bottle. Products that were approved by Appellant were limited in distribution and production.... Eternal Energy was ultimately distributed to a significantly broader area than originally proposed and provisionally approved." *Ex. 3.*

While protecting trade secrets can be a legitimate business purpose, Appellant failed to demonstrate that it entrusted Liquid with confidential information and trade secrets that it sought to protect. Liquid is a bottler. Appellant allowed Liquid to bottle products for 37 competitors. The confidentiality agreement Appellant asked Liquid to obtain from those 37 competitors required only that they not disclose that Liquid had once bottled for Appellant. To the extent that a competitor could glean any trade secrets or other confidential information from Liquid, Appellant chose not to attempt to keep such secrets safe from disclosure. To maintain trade secret protection, an entity must make reasonable efforts to maintain secrecy. MCL 445.1902(d); *Insealator Inc. v Wallace*, 357 Mich 233, 249; 98 NW2d 643 (1959) (no trade secrets existed because patent made them all public). As the trial court concluded, whatever information

Appellant provided to Liquid, it was "generally known" because it was used, with Appellant's approval, "by 37 different manufactures of energy drink products," and because such information was readily ascertainable by "merely inquiring of those 37 approved manufacturers." (Appx. 345-346a, Trial Ct. Op. at 29-30).

As to goodwill, the Court of Appeals correctly rejected Appellant's claim. Appellant has not explained how its reputation or brand could be damaged by allowing competitors to use Liquid as its bottler. Indeed, the one thing that competitors could not do was disclose that their products were bottled in a facility that had previously bottled 5 Hour Energy.

Because Appellant has admitted that the purpose of the anti-competition provision of the Liquid Termination agreement was to allow Appellant to control competition, and because Appellant has not put forward a legitimate business reason for restraining trade, the provision is invalid.

3. Appellant cannot agree with Liquid to restrain trade.

Appellant reaches multiple, unsupported legal conclusions concerning its alleged right to control the use of the Liquid bottling equipment. First, appellant contends that, during the short period when it owned all of the equipment, it had the ability to absolutely control its use. While not strictly relevant to this appeal, that statement is overbroad. As the D.C. Circuit Court of Appeals stated in the Microsoft anti-trust case, a claim of an "absolute and unfettered right" to use property as an owner wishes without exposure to liability is "no more correct than the proposition that one's use of one's personal property, such as a baseball bat, cannot give rise to tort liability." *U.S. v. Microsoft Corporation,* 253 F.3d 34, 63 (2001).

The question, rather, is one of reasonableness of the restraint of trade. Appellant's ownership of all of the bottling equipment for a limited period of time between the execution of the Termination Agreement in April of 2010 and its sale of the equipment back to Liquid in March, 2011, may be one factor in the analysis. But where appellant admits to a 91% market share, that no other "turnkey" facilities exist, and that its motive for the anti-competition agreement is to pick and choose its competitors, that factor should be given minimal consideration.

Similarly, appellant complains that, if it could prohibit any use of the bottling equipment, then it must be able to prohibit some use of the bottling equipment. Again, appellant assumes too much. "The high value that we have placed on the right to refuse to deal with other firms does not mean that the right is unqualified." *Aspen Skiing Co. v. Aspen Highlands Skiing Corp.*, 472 U.S. 585, 601 (1985). "'The right … is neither absolute nor exempt from regulation. Its exercise as a purposeful means of monopolizing interstate commerce is prohibited.'" *Id., quoting Lorain Journal Co. v. U.S.*, 342 U.S. 143, 153 (1951). In these cases, "the question of intent," was critical. *Id.* at 602. "Improper exclusion (exclusion not the result of superior efficiency) is always deliberately intended." *Id.* at 603.

Moreover, even where one has the right to exclude, such as when it has a patent, conditioning the use of the exclusive right such that the conditions constitute an unreasonable restraint of trade is not permissible. "The fact that a patentee has the power to refuse a license does not enable him to enlarge the monopoly of a patent by the expedient of attaching conditions to its use. *U.S. v. Masonite Corp.*, 316 U.S. 265, 277 (1942). *See, also, Lorain Journal, supra* (refusal to sell newspaper advertising to persons that patronized radio station unlawful).

Further, the citations above do not address two additional points – that appellant's acts were not unilateral, and that appellant sold the bottling equipment to Liquid. A business entity must generate new business by competing successfully, "rather than by arranging treaties" with others. *U.S. v. Citizens & Southern N'tl Bank,* 422 U.S. 86, 116 (1975). "A manufacturer ... generally has the right to deal with whomever it likes, as long as it does so independently." *Montsanto Co. v. Spray-Rite Serv. Corp.,* 465 U.S. 752, 761 (1984).

Moreover, appellant's assertions about its ability, as owner of the equipment, to exclude others from its use, simply are not applicable to events occurring after March, 2011, when it sold the equipment to Liquid. Appellant attempts to rationalize the continuation of the anti-compete provisions of the Termination Agreement after the sale by citing cases like *Staebler-Kempf Oil Co. v. Mac's Auto Mart, Inc.,* 329 Mich 351 (1951). But cases upholding anti-compete provisions in the sale context typically involve sales of an entire enterprise, including goodwill. In *Staebler-Kempf,* the seller of the service station owned the station for 20 years, building up goodwill. The court also noted that the seller was "in the weakest competitive position of all Ann Arbor [gasoline] wholesalers. An intra-company price war might well have forced it out of business and would not have appreciably affected the price of gasoline in that highly competitive industry." *Id.* at 358. Under those circumstances, the covenants were upheld.

Here, no goodwill was transferred. All that was sold was bottling equipment. Liquid was prohibited from sharing confidential information with others, and Liquid's customers were prohibited from trading on appellant's goodwill by telling their own customers that their product was bottled by the same company that bottled 5-Hour Energy.

All of the cases can be distilled down to the central points raised by *St. Clair Medical.* Does the restraint of trade protect legitimate business purposes, or is its purpose to prevent competition. In this case, appellant has admitted the latter. The purpose of the Liquid anti-compete provision was to allow appellant to evaluate, on a case by case basis, each competing product to be bottled by Liquid, and to reject those with the potential for broad distribution. (Appx. 152b).

But even absent that admission, the Liquid Termination Agreement is unreasonable. It purports to allow an entity with a 91% market share to pick and choose which competitors will will be able bottle their products with Liquid, in an environment where other "turnkey" bottling facilities do not exist. There are no legitimate purposes for allowing some energy drinks to be so bottled but not others. Certainly, to the extent that any confidential information could be gleaned from the bottling process, or in the unlikely event that goodwill was transferred, allowing 37 other manufacturers to access Liquid, but excluding those who might be able to compete with appellant in major retailers like Wal-Mart, is unreasonable.

The Court should affirm the Court of Appeals' holding that the Liquid Termination Agreement's anti-competition provisions are unreasonable.

III. THE COURT OF APPEALS CORRECTLY RULED THAT THERE WAS A FAILURE OF CONSIDERATION FOR THE K&L AGREEMENTS.

A. Appellant failed to preserve its argument below.

Appellant failed to preserve its argument that the courts below reached erroneous legal conclusions that the non-competition provisions of the K&L Anti-Competition Agreement[7] failed for want of consideration. "This Court has repeatedly declined to consider arguments not presented as a lower level." *Booth Newspapers, Inc., v. Univ. of Michigan Bd. of Regents,* 444 Mich 211, 234 n.23 (1993). The Court only deviates from that rule "in the face of exceptional circumstances." *Id. See, also, Butcher v. Dep't of Treasury,* 425 Mich 262, 276 (1986) (Court declines to consider arguments not raised in Court of Appeals).

[7] The K&L Manufacturing Agreement is not at issue here. That agreement's anti-competition clause only prevents K&L and Krause from designing producing bottling equipment.

The trial court held that the K&L Anti-Competition Agreement "lacked" consideration – that there was no consideration at all. (Appx. 341-42a, trial ct. op. at 25-26). The trial court found that the agreements were signed "*after* Krause and K&L had completed all of the work they would ever perform for the Plaintiff." *Id.*. "Because the parties' relationship did not continue, it cannot provide consideration." *Id.*

In its briefing to the Court of Appeals, appellant virtually ignored the trial court's holding that the agreement failed for lack of consideration. It could have, but chose not to, make arguments that consideration was not required, or that it was sufficient, as it has attempted to in its briefing to this Court. Instead, in its initial brief, appellant ignored the trail court's legal conclusion entirely. (Appx. 290b, Pl. COA initial brief at 49). It spent exactly one paragraph on the court's ruling, focusing only on the factual basis of the trial court's decision. *Id.* Appellant's only arguments in the Court of Appeals were that there was an insufficient factual basis for the trial court's conclusion that K&L was not given any work after the agreement was signed, and that the trial court had failed to allow sufficient discovery. *Id.* Appellant cited no cases or other legal authority whatsoever in the section of its brief on this subject.

Likewise, in its reply, appellant did not attempt to distinguish the cases cited by defendants in their response, or argue the law. Rather, Appellant continued to advance only that the trial court's legal conclusion was not supported by the evidence, and that further discovery was necessary. (Appx. 289-99b).

The Court of Appeals affirmed the trial court's decision on slightly different grounds. It found that the agreements, on their face, contained valid consideration. (Appx. 364a, COA Op. at 11). However, the Court of Appeals held that there was a complete or substantial failure of that consideration because "Krause and K&L Development never received that which they were promised under the agreements." *Id.* Appellant did not seek reconsideration of that ruling.

Now, in this Court, appellant, for the first time, argues that the courts below reached erroneous legal conclusions. Appellant's argument was not preserved and should not be considered by this Court.

B. <u>The K&L Manufacturing Agreement and K&L Anti-Competition Agreement are separate and distinct agreements.</u>

Appellant consistently attempts to conflate the K&L Manufacturing Agreement and the K&L Anti-Competition Agreement, and to mix their terms. The two agreements are separate and distinct and must be viewed independently. While it may be true that "contracts made at the same time, *between the same parties*, with reference to the same subject matter," are to be construed together, these contracts are not "between the same parties" and they have conflicting terms.

The K&L Manufacturing Agreement is among appellant, K&L, and Krause. (Appx. 76a; *see, also,* Appx. 320a, trial ct. op.). The K&L Anti-Competition Agreement, however, is between appellant and K&L only. (Appx. 94a; *see, also,* Appx. 320a, trial ct. op.). Because the agreements are not between the same parties, they cannot be construed together.

Furthermore, the agreements conflict in many respects. For example, the K&L Manufacturing Agreement only bars K&L and Krause from designing or producing competing bottling equipment, while the K&L Anti-Competition Agreement purports to bar K&L (only) from any competition. (Appx. 83a, ¶10 and 97a, ¶6). In addition, the K&L Manufacturing Agreement recognizes an exception to its confidentiality provision, excluding from the definition of Confidential Information "information legally known to Contractor prior to the date" of the agreement (*i.e.,* April 27, 2009). (Appx. 83a, ¶9.4). The K&L Anti-Competition Agreement contains no such exception.

Under these circumstances, the agreements cannot be read together as one contract.

C. <u>The K&L Anti-Competition Agreement does not bind Krause, who is not a party to it.</u>

The K&L Anti-Competition Agreement does not bind Andrew Krause. Krause is not a party to that agreement. (Appx. 94a). He signed the agreement, but as "Managing Member" of K&L, not in his individual capacity. (Appx. 99a). A corporate officer generally is not liable for the obligations of the corporation. *Duray Dev, LLC v. Perrin,* 288 Mich App 143, 151 (2010).

Appellant states in its brief that Krause is a "Utilized Party" under the K&L Anti-Consideration Agreement. "Utilized Parties" are persons "utilized" by K&L to perform work on appellant's premises. (Appx. 95a, ¶2.8). The agreement states that Utilized Parties were to execute separate confidentiality agreements. *Id.* No such agreement bearing Krause's signature has been entered into the record and, even if one were, the agreement's non-compete clause does not purport to bind Utilized Parties. (Appx. 96a, ¶6).[8]

D. <u>The Court of Appeals correctly concluded that consideration failed.</u>

The court of appeals decision that consideration for the K&L Anti-Consideration Agreement failed should be affirmed. A complete or substantial failure of consideration justifies the rescission of a written instrument. *In re Rudell Estate,* 286 Mich App 391, 403 (2009). In *Adell Broadcasting v. Apex Media Services,* 269 Mich App 6, 12-13 (2005), the Court of Appeals defined "failure of consideration" as "'a situation in which … a complete lack of

[8] In any event, to the extent that appellant were to claim that the non-compete clause binds employees of K&L, including Krause, the statute of frauds would bar enforcement, given that there is no written agreement binding Krause, individually, and the three-year term of the non-compete. MCL 566.132(1)(a).

consideration voids the contract.'"[9] *Id. at 13.* The concept, the court said, really refers to a failure of *performance.*" *Id.*, emphasis in original. Failure of consideration occurs when there exists a failure to perform a substantial part of the contract or failure of one of its essential terms, or when the contract would not have been made if default in that particular had not been expected or contemplated. *Id.* at 13-14. The Court of Appeals found that, in contrast to the parties in *Adell,* K&L "never received that which [it] was promised." (Appx. 364a, COA Op. at 11).

As the Court of Appeals held, K&L and Krause never received what they were promised in this case. Though promised that appellant desired to "further engage" them, Appx. 76a, appellant did not order the equipment contemplated by the agreements. (Appx. 14b, Joint Motion to dissolve TRO at 8, verified by Appx. 13a, 2/9/12 Krause Affidavit at ¶ 19). As the trial court correctly concluded, it was uncontested that the contracts were signed after the completion of the work contemplated by the agreements, and that K&L was discharged on May 10, 2009, just 13 days after agreements were signed.[10] (Appx. 320a, Trial Ct. Op. at 4). Appellant put forward no contrary facts.

While "continued employment" may be, in some cases, a basis for consideration, K&L and Krause were not employees. They were independent contractors. The consideration for the broad anti-compete and confidentiality provisions of the K&L Anti-Competition Agreement was the construction of 4-6 new machines – an event that never occurred.[11]

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9 Failure of consideration is a different concept that sufficiency of consideration. *Compare, Rudell Estate, supra,* and *Adell, supra,* with cases cited by appellant.

10 Appellant noted that one of the agreements, the K&L Manufacturing Agreement, had a termination provision providing for termination on 14-days' notice. However, the agreement lasted only 13 days, and there is no evidence in the record that a 14-day notice of termination was ever sent.

11 Appellant speculates on multiple occasions in its brief that K&L must have been paid for its services under the K&L Manufacturing Agreement, arguing that appellees would have raised the fact of non-payment below if it had not been paid. Whether or not K&L was paid is not directly in the record, and therefore it is improper to

Moreover, the agreements executed on April 27, 2009 were a sham, and were offered in bad faith. K&L and Krause provided services to appellant for several years with no written agreement. Then, suddenly, they were presented written agreements containing confidentiality and non-competition provisions,[12] and told that appellant desired to "further engage" K&L. Then, the very next day after the agreements were signed, Krause suddenly had a new "boss," who immediately started mining him for technical information about the bottling lines. 13 days after the agreements were signed, K&L and Krause were dismissed, the promised new equipment never ordered.

As the Court of Appeals held, a party cannot present an anti-competition agreement to another party in bad faith. "Legitimate consideration for the covenant exists as long as the employer does not act in bad faith by terminating the employee shortly after the employee signs the covenant." *Summits 7, Inc. v. Kelly,* 886 A2d 365, 373 (2005) (Vt); *Simko, Inc. v. Graymar Co.,* 464 A2d 1104 ,1107 (Md. App. 1983) ("Were an employer to discharge and employee … in an unconscionably short length of time after extracting the employee's signature … there would be a failure of consideration.").[13] The issue in these opinions is not the adequacy of

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speculate. However, given Krause's testimony that the contemplated equipment was never ordered, it can be inferred that K&L was not paid. Moreover, if K&L were paid, obviously appellant would be in possession of such information and would have had equal motive to present such information below.

12 It is important, again, to distinguish the agreements. The K&L Manufacturing Agreement is the agreement that indicates that it was a written manifestation of previously agreed to oral terms. (Appx. 76a). That agreement names as parties K&L and Krause. The K&L Anti-Competition Agreement was a new agreement. Only K&L, not Krause, is a party. It is a standalone agreement and cannot be construed as a "modification" of any existing agreement. Therefore, MCL 566.1 cannot apply to the K&L Anti-Competition Agreement.

13 Many other jurisdictions agree. In *Labriola v. Pollard Group, Inc.,* 152 Wash.2d 828, 100 P.3d 791 (Wash. 2004) the Supreme Court of Washington ruled that a noncompetition agreement which was executed by an at will employee after already being employed for several years was invalid and the contract failed for lack of consideration. Many courts which have addressed this issue have held in accord with the decision in *Labriola.* See *Access Organics v Hernandez,* 341 Mont. 73, 175 P.3d 899, (Mont. 2008); *Nat'l Recruiters v Cashman,* 323 N.W.2d. 736, 741 (Minn. 1982); *Stevenson v. Parsons,* 96 N.C.App. 93,384 S.E.2d 291,293 (1989); *George W. Kistler, Inc. v. O'Brien,* 464 Pa. 475,347 A.2d 311,316 (Pa. 1975); *Martin v. Credit Prot. Ass'n,* 793 S.W.2d 667, 670 (Tex. 1990); *PEMCO Corp. v. Rose,* 163 W.Va. 420, 257 S.E.2d 885, 890 (W.Va.1979); *Worley v. Wyo. Bottling Co.,* 1 P.3d 615, 621 (Wyo.2000); *McGough v. Nalco Co.,* 496 F.Supp.2d 729 (ND W.Va. 2007); *Piercing Pagoda v Hoffner,* 588 A. 2d. 538 (Pa. 1991).

consideration of the length of time between execution of the non-compete and discharge, it is the Appellant's bad faith and failure to perform. As the trial court held, appellant's bad faith was supported by the record in this case.

Appellant's argument that failure of consideration cannot be based on an event that could have been contemplated by the parties fails. The cases appellant relies on are distinguishable. In *Abbate v. Sheldon Land Co.*, 303 Mich 657 (1942), plaintiff purchased 4 lots in a subdivision for $1,200 each. *Id.* at 659. There was no dispute concerning the transfer of the land. Rather, ten years later, the defendant sought to vacate part of the plat in the subdivision, and act that it was entitled to do, and an act that the plaintiffs knew could occur when they purchased the lots. *Id.* at 664-65. Under those circumstances, there was no failure of consideration. *Id.* This circumstance bears no relation to the facts of the present case.

Similarly, *Rosenthal v. Triangle Dev. Co.*, 261 Mich 462, 463 (1933) dealt with a "partial failure to comply with the terms of a contract." Consideration is not mentioned in *Rosenthal.* The unpublished case of *Crisman-McQuarrie v. McQuarrie,* No. 273266, 2008 WL 723970 (Mich Ct App, Mar 18, 2008), is also distinguishable. In *McQuarrie,* plaintiff was awarded the marital home in a divorce settlement. *Id.* at *1. A tax lien was placed on the home, but had not been foreclosed. Plaintiff knew that there was a large outstanding tax bill and that the recording of a lien was possible. *Id.* at *2. In addition to the home, plaintiff received permanent spousal support, defendant's assumption of all debts to unsecured creditors, defendant's assumption of the tax debt, and payment of the home mortgage. *Id.* at *3. Under those circumstances, the court declined to find a failure of consideration. *Id.*

IV. NO FURTHER DISCOVERY WAS NECESSARY ON APPELLANT'S TRADE SECRET CLAIMS.

Appellant's final argument is that it should have been afforded additional discovery on its trade secrets claim. The Michigan Uniform Trade Secret Act ("MUTSA") defines a "trade secret" as:

> "information … that … (i) derives independent economic value … from not being generally known to, and not being readily ascertainable by proper means by, other persons who can obtain economic value from its disclosure or use [and] (ii) is the subject of efforts that are reasonable under the circumstances to maintain its secrecy." MCL 445.1902(d).

The trial court concluded that no trade secrets had been misappropriated in this case because the information at issue did not meet the definition of a trade secret. (Appx. 345a, Trial Ct. Op. at 29). The trial court viewed the issue before it as an allegation by plaintiff that the use of the bottling equipment used to manufacture Eternal Energy constituted a misappropriation of trade secrets. *Id.* The trial court reasoned that such information was "generally known" because it was used, with the approval of appellant, "by 37 different manufacturers of energy drink products" and because such information was readily ascertainable by "merely inquiring of those 37 approved manufacturers who came into possession of the information without being bound by a duty to disclose." *Id.* at 29-30. Further, the trial court found that authorizing disclosure to 37 different entities without confidentiality agreements was inconsistent with reasonable efforts to maintain the secrecy of the information. *Id.* at 30.

In the trial court, appellant presented only a limited, one paragraph argument (citing no case law) concerning its alleged need for additional discovery. (Appx. 208-209b, 1/9/13 Response to Krause Parties' Motion for Summary Disposition at 18-19; Appx. 230b, 1/9/13 Response to Liquid Motion for Summary Disposition at 19). The only subject on which appellant even suggested that additional discovery was needed concerned "the scope of the

Liquid Defendants' breach of the Confidentiality Provision." *Id.* at 18. Appellant complained that it had not been able to depose two witnesses, asserted that responses to written discovery requests were inadequate and that "while Appellant knows what information it disclosed to the Liquid defendants and the Krause defendants, it requires additional discovery to determine what information disclosed to the Krause Defendants was passed on to the Liquid Defendants." *Id.* Issues and arguments raised for the first time on appeal are not subject to review, absent manifest injustice. *In re Forfeiture of Certain Personal Property*, 441 Mich. 77, 84; 490 NW2d 322 (1992).

In its brief in the Court of Appeals, appellant provided virtually no analysis or rebuttal of the trial court's substantive decision. Appellant's only contention was that it asserted that "a variety of confidential information and trade secrets were misappropriated ... far more than the bottling process for liquid energy shots, which was the only information addressed by the trial court." (Appx. 258b, *Plaintiff/Appellant's Brief on Appeal* at 17). Appellant never explained why the trial court's analysis was wrong, what information the trial court should have considered, or how the MUTSA was violated. In a trade secret case, the burden of proof is on the appellant to plead and prove "the specific nature of the trade secrets." *Dura Global Technologies, Inc. v. Magna Donnelly Corp.*, 662 F. Supp. 2d 855, 859 (ED Mich 2009). "A party alleging trade secret misappropriation must particularize and identify the purported misappropriated trade secrets with specificity." *Id.*

The Court of Appeals agreed that the trial court correctly found that appellant's bottling process "cannot constitute a trade secret where plaintiff disclosed it by expressly authorizing [Liquid] to bottle for 37 companies" without confidentiality agreements. (Appx. 366a, COA Op. at 13). Further, the Court of Appeals stated that "although plaintiff claims that it alleged a variety of other trade secrets, it has, on several occasions, failed to state any trade secrets that were allegedly violated." *Id.*

As to claims that there was insufficient discovery, the Court of Appeals held that "plaintiff fails to provide any independent evidence that a factual dispute exists. Instead, plaintiff simply makes broad, unsupported allegations of what additional discovery could demonstrate. Plaintiff's claim that further discovery will lead to factual support … is nothing more than conjecture." (Appx. 370a, COA Op. at 17).

Both the trial court and Court of Appeals were correct in finding that no further discovery was warranted. "If a party opposes a motion for summary disposition on the ground that discovery is incomplete, the party must at least assert that a dispute does indeed exist and support that allegation by some independent evidence. Mere conjecture does not entitle a party to discovery, because such discovery would be no more than a fishing expedition." *Davis v. Detroit,* 269 Mich.App 376, 379–380; 711 NW2d 462 (2005) (internal citation and quotation marks omitted).

Pauley v. Hall, 124 Mich.App. 255, 263; 355 NW2d 197 (1983) is directly on point. A question in *Pauley* was whether defendants had knowledge of certain oil and gas leases. *Id.* at 259. Defendants moved for summary disposition, and appellant argued that the motion was premature because his discovery on the issue of the defendants' knowledge had not been completed. *Id.* at 263. The court rejected that argument because defendant failed to present independent evidence on the subject:

> If the party opposing a motion for summary judgment cannot present competent evidence of a disputed fact because his or her discovery is incomplete, the party must at least assert that such a dispute does indeed exist and support the allegation by some independent evidence, even if hearsay. An unsupported allegation which amounts solely to conjecture does not entitle a party to an extension of time for discovery, since under such circumstances

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> discovery is nothing more than a fishing expedition to discover if any disputed material fact exists between the parties. *Id.*

However, appellant "alleged only that the Halls *may* have known about his leasehold interest and that he needed time to depose the parties to find out *if* anyone had told the Halls about the lease." *Id. (emphasis in original).* This court held that "[t]his amounts to an insufficient showing of a disputed fact, and the court did not err in refusing Pauley's request for additional time for discovery." *Id.*

Like the plaintiff in *Pauley*, all appellant presented to the trial court in this case was a conclusory statement, claiming that it needed discovery to show what trade secrets were at issue. *Response at 18.* Mere speculation that additional discovery "*might* be able to offer additional pertinent information" is insufficient. *Ensink v. Mecosta Co. Gen. Hosp.*, 262 Mich.App. 518, 540; 687 NW2d 143 (2004) (emphasis in original).

V. APPELLANT HAS ABANDONED ALL OTHER ISSUES DECIDED IN THE COURT OF APPEALS.

The Court of Appeals affirmed the trial court's grant of summary disposition on all of appellant's numerous contract and non-contract causes of action. (Appx. 358a-369a). Appellant cited only three allegations of error: (1) that the Court of Appeals erred in affirming dismissal of Appellant's claim that K&L and Krause breached a non-competition agreement; (2) the Court of Appeals erred in affirming dismissal of appellant's claim that Liquid and Paisley breached a non-competition agreement; and (3) that further discovery was necessary on appellant's breach of trade secrets claim.

Appellant has abandoned all other issues and claims. Thus, the Court of Appeals should be affirmed as to summary disposition of Appellant's other claims, including alleged breaches of the confidentiality provisions of the agreements among the parties, tortious interference, conspiracy, unjust enrichment, conversion, and fraud.

CONCLUSION AND RELIEF

Appellees respectfully request the Court to affirm the Court of Appeals in full and reach the following conclusions:

1. The anti-competition provisions in the K&L Anti-Competition Agreement are unreasonable restraints of trade, void, and unenforceable;
2. The anti-competition provisions in the Liquid Termination Agreement are unreasonable restraints of trade, void, and unenforceable;
3. The K&L agreements are void for failure of consideration;
4. Alternatively, Andrew Krause, individually, is not bound by the K&L Anti-Competition Agreement;
5. No further discovery was necessary on appellant's MUTSA claim and, substantively, appellant failed to show a violation of the act;
6. All other decisions of the Court of Appeals, including its affirmation of the trial court's dismissal of all other contract, tort, and statutory claims in the case, and its holding that Peter Paisley could not be personally liable under the Liquid Termination Agreement, are abandoned in this Court and therefore affirmed.

Respectfully Submitted,

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Dated: November 11, 2015

STATE OF MICHIGAN

IN THE SUPREME COURT

INNOVATION VENTURES, LLC,

Plaintiff/Appellant,

v.

LIQUID MANUFACTURING, LLC, K&L DEVELOPMENT OF MICHIGAN, LLC, LXR BIOTECH, LLC, ETERNAL ENERGY, LLC, ANDREW KRAUSE, and PETER PAISLEY,

Defendants/Appellees.

Supreme Court No. 150591

Court of Appeals No. 315519

Lower Ct. No. 12-124554-CZ

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PROOF OF SERVICE

I hereby certify that I am an employee of Bodman PLC and that on November 11, 2015, I electronically filed Appellee's Brief on Appeal with the Clerk of the Court using the TrueFiling System which will send notification of such filing to all counsel of record.

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